#### Public Policy

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# Modernizing Michigan's Tax Structure: Some things old, Some things new...

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#### Introduction & Disclaimers

- Legislative staff
- Executive Branch roles
- Academic
  - Michigan State
  - Western Michigan
  - Wayne State University, State Policy Center 1998
- Retiree member and Chair, State Employees Retirement Board
- Public Policy Associates, Group Manager and Senior Policy Consultant 2005
- Views expressed are my own



### About these suggestions

- In some cases I specifically suggest use of an item for increased revenue
- In others, I specifically suggest revenue neutrality
- These are suggestions only
- You and your colleagues, and the people of Michigan are the final arbiters of the balance of enhancements, cuts or revenue neutrality
- I submit only that given the size of the structural challenge you face, you will need more revenue

#### First, about the new...

- Repeal the MBT
- Do a revenue neutral replacement via a graduated income tax
- Because the graduated income tax requires voter approval, structure this as a tie-barred change—that is, if the ballot proposal doesn't pass, the MBT remains in place

#### Why repeal the MBT?

- It seems to be uniformly not understood, and widely reviled in the business community—even though lots of businesses had to have been winners...why haven't they come forward?
- Michigan is wasting way too much time on what I believe is the wrong issue—we need to be talking about future goals—and the path to reach them
- Not having a general business tax should be the ultimate tax incentive! And it may allow additional reforms to end some of our collection of other "odds and ends" tax incentives



### What Kind of Graduated Income Tax?

- Seek simplicity: consider no more than about 5 income brackets if you choose to go with a state based approach
- Seek simplicity: consider the option of calculating the state tax due as a percentage of the federal tax due
  - Example: Rhode Island's state income tax is calculated as 25 % of the federal liability of its residents

#### Pros and cons?

- Pro-Michigan desperately needs to put aside decades of non-productive arguing about business taxes
- Pro-to help eliminate the perennial structural deficits, Michigan needs more growth potential in its revenue structure
- Con-historic resistance to graduated tax
- Con-more growth potential also means more volatility



### Second, expand Sales & Use Tax Base to include selected services

- Admissions and amusements, sports (professional & perhaps college, MIS), theaters, movies, museums (Greenfield Village), bowling and golf!
  - People still go to Disney World even though Florida taxes the tickets!
- Services that are primarily to individuals, not businesses
  - Beauty and barbershops; laundry and dry cleaning; cleaning of homes, landscape and lawn services, repair services; legal services to individuals
- Use these for increased revenue part of budget solution



### Third, modernize the structure of some old taxes

■ Convert beer, wine, tobacco from unit base to ad valorem

■ Make these changes revenue neutral at the start, and allow them to grow over time



# Fourth, annually review tax exemptions for policy effectiveness

- Set staggered sunset dates on all to force evaluation
- Set measurable criteria to evaluate effectiveness of all that are renewed
- Set a goal of "X \$\$" to come from the first reviews as part of budget solution
- Start with the largest 20 by dollar size as estimated in the Tax Expenditure report
- Remember, with no general business tax you may not need other business incentive exemptions

### Fifth, restore some old taxes...

- Intangibles Tax
  - Intangibles tax was one of most progressive taxes in Michigan system
  - Needed a lot of investment income to pay it
- Inheritance/Estate Tax
  - Federal tax will continue in some form after 2010
  - A state credit is a virtual certainty
  - Why not keep Michigan dollars in Michigan?



### Sixth, work to restore funding to Budget Stabilization Fund

- If and when recovery comes, resist pressure to spend funds as they come in
- Michigan is likely to remain a volatile economy for many decades
- The sun will come out tomorrow, but we'll also have more rainy days and we should be smart enough to not be surprised by them



## Seventh, evaluate the expenditure side of the budget as well

- Public services by definition should be available to all who qualify
- Some **methods** of service delivery may be more effective than others for same amount of services
- Build in performance criteria to give future legislators an objective way to measure that effectiveness: for new programs and any new tax incentives



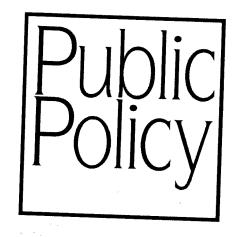
### Eighth, structural reforms take time

- One of the House Speakers I had the privilege to work for used to remind us that
  - "For every complex problem there is always a simple, easy solution."
- "Unfortunately," he also said, "that simple solution is almost always wrong, and at best incomplete."



#### Conclusion

- Resolving the depth of the structural deficit will take time, courage, and compromise
- Everyone will need to step back from some strongly held values to forge those compromises
- Failure to do so almost certainly means that you and Michigan will endure a really painful replay of a tragic, not a comic, version of Bill Murray's "Groundhog Day"



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